Supreme Court, U.S.
FILED
JUL 16 1986
JOSEPH F. SPANIOL, JR.
CLERK

86 NO. 40

In The

Supreme Court of the United States

October Term, 1986

KIDDER, PEABODY & CO. INCORPORATED,

Petitioner,

vs.

INTRE SPORT, LTD.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MATTHEW FARLEY
Counsel of Record for Petitioner
Kidder, Peabody & Co. Incorporated
400 Park Avenue
Suite 1100
New York, New York 10022
(212) 759-6586

SHANLEY & FISHER, P.C.
Attorneys for Petitioner
Kidder, Peabody & Co. Incorporated

BRIAN F. McDONOUGH
On the Petition

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Rutt Appellate Printers, Inc. • NJ (201) 257-6850 • NY (212) 840-9494 • PA (215) 563-5587 MA (617) 542-1114 • DC (202) 783-7288 • USA (800) 5 APPEAL

88 pp

QUESTIONS PRESENTED FOR REVIEW

1. Does a party's federally protected right to compel the arbitration of disputes pursuant to the United States Arbitration Act, 9 U.S.C. §§ 1-14, extend to judicially implied causes of action under the federal securities laws?

2. Does the decision by the Second Circuit Court of Appeals not to compel arbitration of implied causes of action under the federal securities laws conflict with this Court's recent decisions in *Dean Witter Reynolds, Inc. v. Byrd,* 470 U.S. ____, 105 S. Ct. 1238 (1985) and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, ____ U.S. ____, 105 S. Ct. 3346 (1985)?

LIST OF ALL PARTIES

Kidder, Peabody & Co. Incorporated, Petitioner.[1]
Intre Sport, Ltd., Respondent.

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1. Eighty percent of Kidder Peabody's outstanding shares were recently acquired by General Electric Financial Services, a subsidiary of General Electric Company.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

OPINIONS BELOW

The unreported decision of the Second Circuit Court of Appeals was a single page Order summarily affirming the opinion of the District Court. This Order is set forth at page 37a of the Appendix.

The original opinion of the District Court was reported at 625 F. Supp. 1303 (S.D.N.Y. 1985) and is set forth at page 9a

of the Appendix. The subsequent opinion of the District Court reversing its prior decision has not been reported, but is set forth at page 1a of the Appendix.

JURISDICTION

The Order of the Second Circuit Court of Appeals granting summary affirmance of the District Court's April 21, 1986 decision was dated June 17, 1986 and entered on that date. The petitioner utilized the procedure of summary affirmance because the Second Circuit Court of Appeals had recently decided the identical issue in *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. April 16, 1986) and *AFP Imaging Corporation v. Ross*, 780 F.2d 202 (2d Cir. December 23, 1985), *petition for rehearing denied* (February 3, 1986), *petition for cert. filed*, 54 U.S.L.W. 3744 (U.S. May 13, 1986) (No. 85-1805). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

1. The relevant provisions of the United States Arbitration Act, 9 U.S.C. §§ 2, 3, and 4, are set forth at pages 60a through 62a of the Appendix.

2. The relevant provisions of the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78o(c), 78aa, and 78cc, are set forth at pages 63a through 68a of the Appendix.

STATEMENT OF THE CASE

This is an action by a customer of a securities brokerage firm alleging liability for losses incurred in certain securities transactions. The action was commenced in the United States District Court for the Southern District of New York under the jurisdictional provisions of the Securities Act of 1933 (the "1933

Act"), 15 U.S.C. § 77a *et seq.* and the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78a *et seq.* The complaint was subsequently amended to include a claim under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* ("RICO").

In connection with the opening of its margin account, Intre Sport had executed a standard Customer's Agreement which contained the following arbitration provision:

> Any controversy arising out of or relating to accounts of or transactions with or for the undersigned or to this agreement or the breach thereof shall be settled by arbitration in accordance with the rules of either the American Arbitration Association or the New York Stock Exchange as the undersigned may elect. If the undersigned does not make such election by registered mail addressed to you at your main office in New York City within five days after demand by you that such election be made, then you may make such election. Judgment upon any award rendered by the arbitrators may be entered in any court having jurisdiction thereof.

In response to both the complaint and the amended complaint, Kidder Peabody moved for dismissal of all claims under Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2), and the Racketeer Influenced and Corrupt Organizations Act, and arbitration of all remaining claims, including Intre Sport's implied causes of action under Sections 10(b) and Section 15(c) of the 1934 Act.[2] In an opinion and order dated December 23, 1985,

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2. It is highly doubtful that a cause of action may be implied under Section

(Cont'd)

reported at 625 F. Supp. 1303 (S.D.N.Y 1985), the District Court dismissed the Section 12(2) claims on the ground that they were barred by the statute of limitations. The RICO claims were dismissed for failure to state a claim against Kidder Peabody. Finally, the court ordered arbitration of all remaining claims, including those under Sections 10(b) and 15(c) of the 1934 Act.

Subsequently, the Court of Appeals for the Second Circuit issued its decision in *AFP Imaging Corporation v. Ross, supra,* stating that Section 10(b) claims were "of course" non-arbitrable in the Second Circuit. In light of *AFP Imaging,* Intre Sport moved for reconsideration and modification of the District Court's earlier decision compelling arbitration of its implied federal securities law claims. In light of what the District Court characterized as significant "judicial dicta" in *AFP Imaging,* Intre Sport's motion for reconsideration and modification was granted with respect to arbitration of the implied causes of action under the federal securities laws. Intre Sport did not seek reconsideration of the District Court's earlier dismissal of its Section 12(2) claims or RICO claims, or the order compelling arbitration of its pendent state law claims.

At that time the Court of Appeals for the Second Circuit issued its decision in *McMahon v. Shearson/American Express, Inc.,* 788 F.2d 94 (2d Cir. April 16, 1986), which held that claims under Section 10(b) of the 1934 Act, as well as those under

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(Cont'd)

15 of the 1934 Act in light of the guidelines set down by this Court in *Cort v. Ash,* 422 U.S. 66 (1975) and *Touche Ross v. Redington,* 442 U.S. 560 (1979), and for this reason Kidder Peabody also sought dismissal of these claims before the District Court. *See, e.g., Pierson v. Dean Witter Reynolds, Inc.,* 551 F. Supp. 497 (C. D. Ill. 1982). Because of its favorable ruling on Kidder Peabody's motion to compel arbitration, the District Court did not reach this question.

the Racketeer Influenced and Corrupt Organizations Act, were not arbitrable under the Federal Arbitration Act.

Because the *McMahon* and *AFP Imaging* decisions are in direct conflict with this Court's recent teachings in *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. ____, 105 S. Ct. 1238 (1985) and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, ____ U.S. ____, 105 S. Ct. 3346, Kidder Peabody appealed from the District Court's order and then moved for summary affirmance before the Second Circuit Court of Appeals. That motion for summary affirmance was granted on June 17, 1986.

REASONS FOR GRANTING THE WRIT

For many years, the federal courts had refused to enforce arbitration agreements between brokerage firms and their customers in disputes involving implied causes of action under the federal securities laws. This policy was questioned by this Court in *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. ____, 105 S. Ct. 1238 (1985), and effectively rejected by this Court's subsequent reasoning in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, ____ U.S. ____, 105 S. Ct. 3346 (1985). Notwithstanding this Court's teachings in *Byrd* and *Mitsubishi*, the United States Court of Appeals for the Second Circuit and a number of lower courts continue to deny parties their federally protected right to arbitrate disputes involving implied claims under the federal securities laws.

The majority of lower courts have begun to compel arbitration of implied federal securities law claims in light of *Byrd* and *Mitsubishi*. However, the burgeoning patchwork of disparate holdings by the lower courts on this issue renders arbitration agreements involving customers of national and local securities firms, all engaged in interstate commerce across the nation, of dubious and uncertain enforceability. This uncertainty as to the state of the law has precipitated an eruption of federal litigation over this question, to the detriment of the securities industry, the investing public, and the judicial system. For this reason, as well as those to follow, there is an urgent need for this Court to resolve this timely and controversial question.

I.

The holdings of the Second Circuit wrongfully deprive parties of their right to enforce arbitration agreements in transactions involving the purchase or sale of securities.

The United States Arbitration Act expressly provides that:

> A written provision in . . . a contract evidencing any transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable. 9 U.S.C. § 2.

In a progression of recent cases including *Moses H. Cone Memorial Hospital v. Mercury Construction Corporation,* 460 U.S. 1 (1983) and *Southland Corp. v. Keating,* 465 U.S. 1 (1984), this Court has repeatedly affirmed its commitment to arbitration as a valuable means of resolving disputes, recognizing that the purpose of the Arbitration Act was to reverse

> centuries of judicial hostility to arbitration agreements, [and] was designed to allow parties to 'avoid the costliness and delays of litigation, and to place arbitration agreements upon the same footing as other contracts'.

Scherk v. Alberto-Culver Company, 417 U.S. 506, 510-11 (1974). Again in *Dean Witter Reynolds, Inc. v. Byrd, supra,* this Court stated that:

> the preeminent concern of Congress in passing the [Arbitration] Act was to enforce agreements into which parties had entered, and that concern requires that we rigorously enforce agreements to arbitrate. 105 S. Ct. at 1242-43.

This strong national policy requires "that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration." *Moses Cone, supra,* 460 U.S. at 24-25.

In *Mitsubishi,* this Court found these policies to be equally compelling even in cases where the dispute arose under a federal statute. Parties raising statutory claims, such as those here, should be held to their bargain to arbitrate unless Congress has specifically exempted that statutory claim from the reach of the Arbitration Act:

> Just as it is the Congressional policy manifested in the Federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by that Act, it is the Congressional intention expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable. . . . 105 S. Ct. at 3355.

Despite this Court's clear instruction that denial of an otherwise enforceable arbitration agreement must be predicated upon a clearly expressed congressional intention, rather than the courts' own views as to the relative importance of various legislation, the Second Circuit has declined to enforce an agreement to arbitrate under just such a circumstance.

The Second Circuit premised its holding in *McMahon* in part on the non-waiver provision contained in Section 29 of the 1934 Act.[3] In *Wilko v. Swan,* 346 U.S. 427 (1953), the analagous non-waiver provision of the 1933 Act had been held to preclude

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3. Section 29(a) of the 1934 Act provides:

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

arbitration of the unique, congressionally created right of action found in Section 12(2) of that Act. Unlike the special express cause of action in *Wilko*, however, the implied cause of action under Section 10(b) was judicially engrafted onto the 1934 Act decades after its passage by Congress. Surely Congress could not have intended this nonwaiver provision to apply to causes of action that it neither created nor foresaw in 1934.

In addition to Section 29 of the 1934 Act, the Second Circuit found that "strong public policy concerns" abrogated the right to compel arbitration of a Section 10(b) claim. However, the central teaching of *Mitsubishi* was that courts may not abrogate valid arbitration aqreements based on their own views of public policy. Just as it was Congress who created the statutory right to arbitration, it is Congress alone who can withdraw that right when it believes that competing national policies so require. Congress has not done so in the case of implied federal securities law claims and, until it does, the business people and investors who agree to arbitrate these disputes should be held to their bargain.

II.

The holdings of the Second Circuit conflict with this Court's teachings in *Byrd* and *Mitsubishi*.

The holdings of the Second Circuit in *AFP Imaging* and *McMahon* cannot be reconciled with this Court's teachings in *Byrd* and *Mitsubishi*. While *Mitsubishi* involved antitrust claims in the context of an international transaction, this Court systematically dismantled each and every intellectual underpinning of the "*American Safety*" doctrine under which domestic antitrust

claims had been held non-arbitrable.[4]

Moreover, there is no principled basis for restricting *Mitsubishi* to either the field of antitrust law or to international transactions. Indeed, given this Court's willingness to entrust the administration of rights and remedies granted by Congress under the federal antitrust laws to a foreign arbitration tribunal applying foreign procedural laws, one must assume *a fortiori* that Congress is more than prepared and willing to entrust federal remedies under the securities laws to the experienced and learned arbitrators who serve on the arbitration panels of the securities exchanges and the National Association of Securities Dealers (all under the oversight and supervision of the Securities and Exchange Commission) and the American Arbitration Association.

III.

There is a compelling need throughout the judicial system for this Court to resolve the arbitrability of implied federal securities law claims.

Few issues in the last year have caused more litigation and confusion among the lower courts than the arbitrability of implied federal securities law claims. Prior to *AFP Imaging* and *McMahon*, six out of eight decisions in the Second Circuit had compelled arbitration of such claims. Notwithstanding the Second Circuit's holdings in *McMahon* and *AFP Imaging*, numerous district courts continue to hold that Section 10(b) claims are arbitrable in light of *Byrd* and *Mitsubishi*. Nearly 100 District Court decisions have addressed this issue since *Byrd* was decided, and more than two-

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4. This doctrine draws its name from the decision in *American Safety Equipment v. J.P. Maguire*, 391 F.2d 821 (2d Cir. 1968), which held antitrust claims to be non-arbitrable as a matter of public policy notwithstanding any express congressional exception to the contrary.

thirds of these decisions have ruled in favor of arbitration of implied federal securities law claims. The question is presently pending before the Third, Fifth and Ninth Circuits, and additional appeals are all but inevitable. The explosion of litigation over this question, as well as the disparity of results among the lower courts, cries out for final resolution by this Court.

IV.

The federal court dockets could be relieved of substantial congestion if arbitration agreements involving implied federal securities law claims were enforced.

For the latest year in which the statistics are available, it has been reported that more than 3,000 civil actions were filed in the federal district courts in the 12 months ending March of 1984 in which the claims were denominated as arising under the Federal Securities and Commodities Exchange Acts. Because arbitration agreements are frequently embodied in routine securities and commodities account documentation, a significant amount of such claims would undoubtedly be submitted to arbitration and substantial congestion of the federal dockets would be alleviated.

CONCLUSION

The decisions by the Second Circuit below conflict not only with this Court's teachings in *Dean Witter Reynolds, Inc. v. Byrd,* 470 U.S. ____, 105 S. Ct. 1238 (1985) and its holding in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, ____ U.S. ____, 105 S. Ct. 3346 (1985), but with the Court's overall policy of vigorously enforcing the Arbitration Act in recent years. Review of the questions raised by this petition would not only vindicate the integrity of the Court's prior holdings, it would vindicate the federally protected right of countless individuals and financial institutions to arbitrate judicially implied claims arising under the federal securities laws. Finally, a decision by this Court would relieve the lower courts of the proliferation of litigation over this issue that was precipitated by *Dean Witter Reynolds, Inc. v. Byrd,* 470 U.S. ____, 105 S. Ct. 1238 (1985).

For these and the foregoing reasons, petitioner respectfully requests that this petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit be granted.

Respectfully submitted,

MATTHEW FARLEY
A Member of the Bar of the Supreme Court and Counsel of Record for Petitioner Kidder, Peabody & Co. Incorporated

SHANLEY & FISHER, P.C.
Attorneys for Petitioner Kidder, Peabody & Co. Incorporated

BRIAN F. McDONOUGH
On the Petition

APPENDIX A—ORDER AND OPINION OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED APRIL 21, 1986

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

85 Civ. 1968 (RWS)

INTRE SPORT, LTD.,

Plaintiff,

-against-

KIDDER, PEABODY & CO., INCORPORATED,

Defendant.

OPINION

APPEARANCES:

ROGERS, HOGE & HILLS, ESQS.
Attorneys for Plaintiff
90 Park Avenue
New York, New York 10016
By: LYNDA G. JACOBS, ESQ.
WILLIAM J. FOSTER, IV., ESQ.
Of Counsel

SHANLEY & FISHER, P.C.
Attorneys for Defendant
400 Park Avenue—Suite 1100
New York, New York 10022
By: MATTHEW FARLEY, ESQ.
BRIAN F. McDONOUGH, ESQ.
Of Counsel

Appendix A

SWEET, D.J.

Plaintiff Intre Sport Ltd. ("Intre Sport") brings this motion for reargument under Civil Rule 3(j), Rules of the United States District Court for the Southern District of New York, seeking modification of a prior judgment of this court pursuant to Rule 59(e), Fed.R.Civ.P. In this motion Intre Sport challenges the portion of the December 23, 1985 opinion which dismissed and compelled arbitration of Intre Sport's claims based on violations of the Securities and Exchange Act of 1934, Sections 10(b) and 15(c), 15 U.S.C. §§ 78(j)(b), 78(o)(c). For the reasons set forth below, Intre Sport's motion for modification of the judgment is granted.

Prior Proceedings

On September 10, 1985, defendant Kidder Peabody & Co., Inc. ("Kidder Peabody") moved to dismiss, or in the alternative, compel arbitration of Intre Sport's claims which arise out of two allegedly fraudulent transactions in securities. By opinion of December 23, 1985, this court dismissed Intre Sport's claims based on violations of Section 12(c) of the Securities Act of 1933, and claims alleging violations of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* and referred the remaining federal securities claims and pendent common law fraud claims to arbitration as was provided by the Customer's Agreement governing the business relationship among the parties.

Relying on the Supreme Court's recent opinion in *Dean Witter Reynolds Inc. v. Byrd*, ____ U.S. ____, 105 S.Ct. 1238 (1985), this court held that Kidder Peabody could require Intre Sport to arbitrate its claims under Sections 10(b) and 15(c) of the

Appendix A

1934 Act.[1] Although the *Byrd* Court considered the arbitrability of 1934 Act claims an "open question," this court interpreted the language and reasoning of the opinion as an endorsement of the arbitrability of 1934 Act claims:

> "[T]he *Byrd* opinion's strong language casting doubt on the continued non-arbitrability of federal securities law claims, the Supreme Court's renewed vigor in enforcing agreements to arbitrate under the Federal Arbitration Act, and the significant differences between the implied private rights of action under the 1934 Act and the 1933 Act sections held non-arbitrable by the Supreme Court . . . require that these federal securities claims must be referred to arbitration.

Intre Sport Ltd. v. Kidder Peabody & Co., Inc., 85 Civ. 1968 (S.D.N.Y. December 23, 1985) (slip op. at 16).

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1. In concluding that *Dean Witter Reynolds* ushered in a new era of arbitrability for 1934 Act claims, this court joined a growing number of courts in this circuit, *Shamir v. Kidder Peabody & Co., Inc.*, 84 Civ. 0179 (S.D.N.Y., March 11, 1986); *Brener v. Becker Paribas, Inc.*, 84 Civ. 5872 (S.D.N.Y., December 31, 1985); *Ilan v. Shearson/American Express, Inc.*, 83 Civ. 9319 (S.D.N.Y., December 20, 1985); *Finkle and Ross v. A.G. Becker Paribas*, 85 Civ. 1858 (S.D.N.Y., December 2, 1985); *Jarvis v. Dean Witter Reynolds, Inc.*, No. 83 Civ. 383 (D.Vt., August 6, 1985); *McMahon v. Shearson/American Express, Inc.*, 618 F. Supp. 384 (S.D.N.Y. 1985) and others; *Dees v. Smith Barney Harris Upham & Co.*, 84 Civ. 8678 (C.D.Cal., July 31, 1985); *Bateh v. Prudential Bache Securities, Inc., et al*, 84-526-Civ. J-14 (M.D. Fla., July 29, 1985); *Sevinor v. Merrill Lynch, Pierce Fenner & Smith*, No. 84-3240-N (D.Mass., July 19, 1985); *Finn v. Prudential-Bache Securities*, No. 84-8414 (S.D.Fla., June 20, 1985); *Coonly v. Rotan Mosle, Inc., et al.*, No. A-83-CA-529 (W.D.Tex., June 4, 1985); *Raiford v. Merrill Lynch, Pierce Fenner & Smith*, No. C93-65A (N.D.Ga., May 16, 1985); which have held that Section 10(b) claims are arbitrable.

Appendix A

On December 23, 1985, the same day on which this court issued the above quoted opinion, the Second Circuit issued its opinion in *AFP Imaging Corporation v. Ross,* 780 F.2d 202 (2d Cir. 1985), reversing in part a district court opinion dismissing plaintiff-appellant's section 10(b) claim. Although the *AFP Imaging* Court did not have the issue of the arbitrability of the securities law claims squarely before it, as the district court had dismissed the Section 10(b) claim and had referred only the common law claims to arbitration, the court stated:

> Although the contract provided that all controversies arising under or in connection with it would be settled by arbitration, this provision is, of course, unenforceable under the law of this Circuit insofar as the securities law claim is concerned. *Greater Continental Corp. v. Schechter,* 422 F.2d 1100, 1103 (2d Cir. 1970). *Cf. Dean Witter Reynolds, Inc. v. Byrd,* 105 S.Ct. 1238, 1240 n.1 (1985), indicating that the Supreme Court considers this an open question.

Id. at 205.

This sentence, noting that the Supreme Court considers the question open, reaffirms its prior determination that claims arising from alleged violations of the Securities and Exchange Act of 1934 are outside the scope of the federal Arbitration Act without considering the implications of *Byrd* as perceived in the December 23 opinion of this court. *See also Couvaras v. Paine Webber Jackson & Curtis, Inc. et al,* 84 Civ. 2421 (February 24, 1986 S.D.N.Y.).

Kidder Peabody contends that this single sentence of dictum

from the Second Circuit's *AFP Imaging* opinion is not controlling and should be read as a "comment" rather than as an affirmation of the Second Circuit's pre-*Byrd* non-arbitrability views. As support for this position, Kidder Peabody points to both a recent Supreme Court opinion, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, ____ U.S. ____, 105 S.Ct. 3346 (1985) and the Second Circuit's opinion in *Rush v. Oppenheimer & Co.*, 85-7335 (2d Cir., December 20, 1985). In *Mitsubishi Motors*, the Court held that in an international law context, federal antitrust claims are fully arbitrable and enjoy no immunity from the federal Arbitration Act. In reaching this conclusion, the *Mitsubishi* Court expressed its belief that:

> Just as it is the congressional policy manifested in the Federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by that Act, it is the congressional intention expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will beheld unenforceable. *See Wilko v. Swan*, 346 U.S. at 434-35; *Southland Corp.*, ____ U.S., at ____ (concurring opinion (slip op. 13, n.11); *Dean Witter Reynolds, Inc.*, ____ U.S. at ____ (concurring opinion (slip op. 1-2).

105 S.Ct. at 33.

This reasoning questions an arbitration exemption for statutes not explicitly granting protection from waiver, such as the implied causes of action in the 1934 Act which fall outside the scope of the non-waiver provisions of the Act.

Appendix A

Kidder Peabody contends that this Supreme Court preference for an express legislative exemption from the arbitration act should be read in conjunction with the Second Circuit's opinion in *Rush v. Oppenheimer, supra,* slip op. at 753, which seemed to state that a belief in the arbitrability of federal securities claims was reasonable after *Dean Witter reynolds, Inc. v. Byrd, supra,* 105 S.Ct. 1238:

> Similarly, defendant's participation in discovery did not preclude them from demanding arbitration. In addition to his arbitrable common law claims of breach of fiduciary duty, Rush also alleged federal securities claims that defendants "reasonably perceived" to be non-arbitrable. *Dickinson v. Heinhold Securities, Inc.,* 661 F.2d 638, 642 (7th Cir. 1981); *see Wilko v. Swan,* 346 U.S. 427, 438 (1953); *see also Allegaert v. Perot,* 548 F.2d 432, 437-38 (2d Cir.). *cert. denied,* 432 U.S. 910 (1977); *Greater Continental v. Schechter,* 422 F.2d 1100, 1103 (2d Cir. 1970); *Starkman v. Seroussi,* 377 F. Supp. 518, 522 (S.D.N.Y. 1974); *cf. Dean Witter Reynolds, Inc. v. Byrd,* 105 S.Ct. 1238, 1240 n.1 (1985) (discussing without deciding the arbitrability of § 10(b) and rule 10b-5 claims). "[N]o waiver of the right to discovery can occur from conducting discovery on non-arbitrable claims." *Dickinson,* 661 F.2d at 642. Since Rush is unable to point to any specific discovery conducted by defendants that was not relevant to the securities claims, he cannot establish that prejudice in the arbitration would result from that discovery. *See Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* [1984 Transfer Binder]

Appendix A

Fed.Sec.L.Rep. (CCH) ¶91,650 at 99,294 (D.Minn. August 6, 1984).

Rush v. Oppenheimer & Co., 85-7335 (December 20, 1985) (slip op. at 754).

Kidder Peabody claims that the *Rush* panel's statement that plaintiff's federal securities claims were only "reasonably perceived" to be non-arbitrable, rather than conclusively non-arbitrable under Second Circuit precedent, and the court's observation that *Dean Witter Reynolds* left the arbitrability of Section 10(b) and Rule 10b-5 claims an "open question," combine to offset the dictum in *AFP Imaging*, particularly in light of the Supreme Court's broad reading of the applicability of the federal Arbitration Act to statutory claims in *Mitsubishi*.

However, this equivocal dictum in *Rush v. Oppenheimer, supra* 85-7335 (2d Cir. December 20, 1985) and the general federal Arbitration Act standards announced in *Mitsubishi* cannot override the Second Circuit's explicit, if unexplained, endorsement of the continued non-arbitrability of federal securities law claims in *AFP Imaging Corp. v. Ross, supra*. Although Kidder Peabody correctly observed that this arbitrability issue was not briefed initially in *AFP Imaging*, these arguments were presented to and rejected by the Second Circuit in its February 3, 1986 denial of appellees' petition for a rehearing *en banc*. In addition, although the citation to *Greater Continental Corp. v. Schechter, supra*, 422 F.2d 1100, was not part of the holding in *AFP Imaging*, it was significant "judicial dicta" which directed the district court to retain the remanded Section 10(b) claim rather than send it to arbitration. *See Gilmore v. Shearson/American Express, Inc.*, 84 Civ. 9011 (S.D.N.Y. February 1, 1986) (Report of Mag. L. Bernikow) (slip op. at p. 5-7).

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Under these circumstances, this court must modify its prior opinion of December 23, 1985 to reinstate the implied causes of action under Section 10(b) and Section 15(c) of the 1934 Act which had been referred to arbitration.

IT IS SO ORDERED.

DATED: New York, N.Y.
April 21, 1986

s/ Sweet
ROBERT W. SWEET
U.S.D.J.

APPENDIX B—ORDER AND OPINION OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED DECEMBER 23, 1985

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

85 Civ. 1968 (RWS)

INTRE SPORT, LTD.,

Plaintiff,

-against-

KIDDER, PEABODY & CO., INCORPORATED,

Defendant.

OPINION

APPEARANCES:

ROGERS, HOGE & HILLS, ESQS.
Attorneys for Plaintiff
90 Park Avenue
New York, New York 10016
By: LYNDA G. JACOBS, ESQ.
WILLIAM J. FOSTER, IV., ESQ.
Of Counsel

SHANLEY & FISHER, P.C.
Attorneys for Defendant
400 Park Avenue—Suite 1100
New York, New York 10022
By: MATTHEW FARLEY, ESQ.
Of Counsel

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SWEET, D.J.

Defendant Kidder, Peabody & Co., Inc. ("Kidder, Peabody") moves for an order of dismissal under Rule 12(b), Fed.R.Civ.P., or in the alternative, arbitration of the claims of plaintiff Intre Sport, Ltd. ("Intre Sport") which arise out of two sets of allegedly fraudulent transactions in securities. Kidder Peabody seeks the following relief: 1) dismissal of all claims alleged under section 12(2) of the Securities Act of 1933; 2) dismissal of the claim arising under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq* (hereinafter "RICO"); 3) compelled arbitration of all other claims, including any remaining RICO claims and implied causes of action under the federal securities laws; and 4) dismissal of the federal securities laws claims if they are not referred to arbitration. For the reasons set forth below, the motion to dismiss the claims under RICO and Section 12(2) of the Securities Act of 1933 is granted, and the remaining federal securities law and common law fraud claims are referred to arbitration.

Prior Proceedings

Intre Sport filed this action on March 13, 1985, alleging claims arising under section 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2), section 10(b) and 15(c) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78o(c) and various common law breaches of contract, breaches of fiduciary duty, and fraud.

Kidder, Peabody filed a motion seeking dismissal and arbitration of the initial complaint on May 3, 1985, and on August 13, 1985, Intre Sport filed both an opposing brief and an amended complaint, adding a claim under section 1964(d) of RICO. Kidder,

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Peabody withdrew its original motion, and on September 6, 1985 made a motion to dismiss the amended complaint, or alternatively, to submit all of Intre Sport's claims, except for those arising under section 12(2) of the Securities Act, to arbitration. For the convenience of the court, Kidder, Peabody consolidated all of its arguments in its September 1985 brief, superseding the earlier May 3, 1985 brief. Matters outside the pleadings and the memoranda of law have not been considered in deciding this motion, and it remains a motion to dismiss on the pleadings pursuant to Federal Rules of Civil Procedure 12(b)(6) and 12(c).

The Parties

Intre Sport, formerly known as International Trends, Inc. ("International Trends") is a corporation duly incorporated in the State of New York, with its principal place of business at 350 Fifth Avenue, New York, New York.

Kidder, Peabody is a corporation with its principal place of business at 10 Hanover Square, New York, New York, and is a registered broker-dealer under section 15 of the Securities Exchange Act and is a member of the National Association of Securities Dealers, Inc. ("NASD"), the New York and American Stock Exchanges and most major securities, options and commodities exchanges.

The Pleadings

For the purposes of this motion, the facts as alleged in the complaint are accepted as true. In April, 1982, Robert J. Turner ("Turner"), President and Chief Executive Officer of International Trends (now Intre Sport), met Peter N. Brant ("Brant"), a Vice President of Kidder, Peabody employed at its 101 Park Avenue,

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New York City branch office, who introduced himself to Turner as a highly successful broker with Kidder, Peabody who insisted on complete discretion over his customer's accounts. Turner reported to Brant that his company maintained securities brokerage accounts at other investment firms and had substantial investments in the stock market. Brant told Turner that he never followed Kidder, Peabody's recommendations but instead "specialized in identifying small companies with significant growth potential" and that he was able to develop close confidential relationships with the management of these companies which enabled him to "obtain valuable information in advance of the public."

In April, 1982, Intre Sport opened a margin account with Kidder, Peabody and executed a standard Customers Agreement which provided in relevant part as follows:

> Any controversy arising out of or relating to accounts of or transactions with or for the undersigned or to this agreement or the breach thereof shall be settled by arbitration in accordance with the rules of either the American Arbitration Association or the New York Stock Exchange as the undersigned may elect. If the undersigned does not make such election by registered mail addressed to you at your main office in New York City within five days after demand by you that such election be made, then you may make such election. Judgment upon any award rendered by the arbitrators may be entered in any court having jurisdiction thereof.

Both Turner and Intre Sport's Executive Vice President Peter J. MacLeod ("MacLeod") were listed as having authority over the corporation's account.

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Two sets of transactions are involved: Intre Sport's purchase of the stock of American Surgery Centers, and Brant's alleged failure to sell certain securities in January, 1984.

American Surgery Centers Stock

In March, 1983, Brant purchased 25,000 shares of American Surgery common stock for Intre Sport's account, at a price of $6.4780 per share for a total investment of $161,950.00. Brant told Turner and MacLeod that he had extensive knowledge about American Surgery and that he was personal friends with and regularly contacted employees of the company, including Greg Michael, its Executive Vice President. By May of 1983, American Surgery's price per share had doubled to $12.875.

During this period of rapid increase in the value of the stock, Brant telephoned Turner and MacLeod with what he described as "a deal which will change your lifestyle." He explained that American Surgery was issuing an unregistered secondary offering of common stock. While the offering was already oversubscribed, Brant told Turner and MacLeod that since he had been instrumental in assisting the company in arranging for the sale, he would be able to obtain 25,000 shares at $4.00 for the Intre Sport account. Brant also told them he had discussed the issue with Kidder, Peabody but was being paid for his efforts by American Surgery, either through cash commissions or American Surgery common stock.

Familiar with both the risks and nature of a restricted offering, Turner expressed concern about investing $100,000 in a restricted stock. Allegedly, Brant reassured him that there was no reason for concern since he had an arrangement with the management whereby American Surgery would register the first 25% of the

private placement issue within three months of the offering; 50% by year end, and would register the balance of the offering "soon thereafter." Turner and MacLeod visited Brant at his office on or about May 12, 1983 and expressed concern about the restricted nature of the stock. Brant repeated his earlier representation that the company had agreed to register the securities in a very short period of time. He also predicted that the value of American Surgery shares would continue to rise to the point where they would be worth $16.00 per share by the time the restricted shares were freed for trading.

During the same meeting, Brant told Turner and MacLeod that they should not hesitate to invest in American Surgery stock because he had personally invested approximately $800,000 in the restricted offering and produced a check to this effect. Again, Brant repeated to Turner and MacLeod that he was close to the top management of American Surgery, and that they "were going to make a lot of money on the deal."

Brant gave Turner and MacLeod further assurances that "if there was ever any reason for concern about the company they would, in any event, be the first to know since he would receive such information in advance of the general public." In reliance on these representations, Turner and MacLeod agreed to purchase approximately $100,000 of the restricted stock.

The factual accounts of the parties diverge somewhat over the events surrounding the "Limited Offering Memorandum." Intre Sport contends that Brant filled out the name of the purchaser and the distribution date, and tore off the back pages of the document which contained financial information relative to the purchasers and to the subscription agreement. Brant then asked Turner and MacLeod to sign the subscription agreement as "a

formality." Kidder, Peabody's memorandum of law is silent on this incident, other than to state that Turner and MacLeod signed the agreement.

The American Surgery restricted shares were never registered in 1983 as Brant promised, and are currently not saleable in the secondary (public) securities market. The price of the common stock plummeted from $14.25 per share in June, 1983 to $3.125 in February, 1984. From May, 1983 through February, 1984, Turner and MacLeod had numerous conversations about the declining value of the shares and the company's failure to live up to the registration commitments. Brant continued to assure them that American Surgery was financially sound, and that the drop in stock price had prompted the company to postpone registering the private placement. Brant also insisted that the company intended to register the stock as soon as the secondary market price improved, and Intre Sport continued to hold, as of February, 1984, the original 25,000 shares of publicly traded stock and the 25,000 shares of private placement stock.

In April, 1984, Turner and MacLeod read a series of newspaper articles in *The Wall Street Journal* indicating that the Securities and Exchange Commission was investigating Brant's activities. The following month, the two officers learned that an action was filed against Kidder, Peabody in this court entitled *Huang v. Kidder, Peabody,* No. 84 Civ. 1798 (S.D.N.Y. 1984), alleging securities fraud in connection with the American Surgery private placement stock. Intre Sport then retained counsel to prosecute this action.

The January 1984 Sell Orders

As the second component to its claim, Intre Sport alleges

that Brant failed to liquidate certain securities in its account despite the fact that Turner and MacLeod gave clear and definite orders to sell the shares. In May, 1983, the equity in Intre Sport's Kidder Peabody account reached its highest level, $1,644,272.10, from its low of $28,750.00 in April, 1982. During the summer of 1983 several of the stocks began to decline in value and the equity began to fall. Turner and MacLeod had telephone conversations discussing these falling prices with Brant on numerous occasions from May, 1983 through September, 1983, in which they expressed their opinion that Brant should consider liquidating the account before any more losses were incurred. Brant, by contrast, expressed confidence that the market would recover and urged them to hold their positions.

On or about October 13, 1983, Turner spoke to Brant over the telephone and allegedly instructed him to start selling nine of the twelve securities positions then open in the account. However, Brant failed to sell seven of the nine positions as instructed. During the months of November and December, 1983 there were several more telephone conversations between Turner, MacLeod, and Brant. Asked to explain his failure to sell as directed, Brant responded that he did not execute the orders because it would have caused a significant drop in the market price of the thinly traded stock, and would have caused harm to himself and his other customers maintaining substantial positions in the stock. Because of a slight recovery in two of the stocks, it was agreed that the sale of the seven positions in question would be postponed.

On January 26, 1984, Turner telephoned Brant and instructed him to sell six of the remaining securities positions at the market. Rather than selling the seurities on January 26, as allegedly instructed, Brant sold the securities four to six days later. When

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Turner received the trade confirmation statements and learned that the securities had not been sold on January 26, 1984, he contacted Brant to demand an explanation. Brant acknowledged that he had disregarded Turner's instructions because he refused to sell when the market price was rapidly falling and a sudden sale would have further "destroyed" stock prices. As a result of this alleged failure to sell, Intre Sport claims to have sustained damages of $17,912.50.

Intre Sport alleges that this failure to sell "was part of a fraudulent scheme between Brant and others to avoid depressing the market further in each of the securities in question and to otherwise permit Brant and other customers to sell the same securities at more favorable prices" and before Intre Sport could sell its shares.

Discussion

The Civil RICO Claim

Intre Sport claims that Brant and Kidder, Peabody violated section 1962(c) of the Racketeer Influenced and Corrupt Organizations Act, by engaging in a "pattern of racketeering activity," entitling Intre Sport to recover treble damages, the cost of suit, and reasonable attorney's fees under § 1964(c) which creates a private civil right of action under the statute. Section 1962(c) provides:

> It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities which affect interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's

> affairs through a pattern of racketeering activity or collection of unlawful debt.

Section 1961(5) defines a "pattern of racketeering" to include the commission of two or more specified predicate criminal acts within a ten-year period, including fraud in the sale of securities, and acts of mail and wire fraud under 18 U.S.C. § 1341 and § 1343. 18 U.S.C. § 1961(1)(A) and (D).

Kidder, Peabody claims that Intre Sport's civil RICO claim is defective because: 1) Kidder, Peabody cannot be named as both "person" or violator and "enterprise";[1] 2) Kidder, Peabody is not a "person" who violated the requisite criminal predicate acts; and 3) Intre Sport has not pleaded the existence of a "pattern" of racketeering activity under the statute.

"Enterprise" or "Person"

Kidder, Peabody contends that Intre Sport must differentiate between an "enterprise" and "person" under section 1962(c), because the statute contemplates a violator who conducts his affairs through an enterprise. The Second Circuit in *Bennett v. United States Trust,* 770 F.2d 308 (2d Cir. 1985) recently endorsed this requirement that "enterprise" and "person" be separate and distinct entities in a RICO claim under section 1962(c):

> . . . requiring a complaint to distinguish between the enterprise and the person conducting the affairs of that enterprise in the prohibited manner is supported by the plain language of section 1962(c), which clearly envisions two entities. Moreover, requiring a distinction between the enterprise and the person comports with legislative intent and

> policy. Such a distinction focuses the section on the culpable party and recognizes that the enterprise itself is often the victim of the racketeering activity (citing cases). *Thus, we follow the majority view and hold that under section 1962(c) a corporate entity may not be simultaneously the "enterprise" and the "person" who conducts the affairs of the enterprise through a pattern of racketeering activity.*

Id. at 315 (emphasis added).

Intre Sport claims that *Bennett* does not control the situation at bar because "The circumstances and concerns which led the Second Circuit to its decision in *Bennett* are inapposite here, where the corporation, while cast as both the 'person' and the 'enterprise' was an active perpetrator of the fraud, and not a passive tool or instrument." (Plaintiff's supplemental memorandum, p. 10) However, this interpretation of the *Bennett* holding disregards both the line of cases endorsed by the *Bennett* court requiring the pleading of distinct "enterprise" and "person" under section 1962(c), and inaccurately describes the factual allegations contained in Intre Sport's amended complaint.

First, the holding in *Bennett,* emphasized above, was an endorsement of the Court of Appeals majority view that the language and intent of section 1962(c) requires this pleading distinction and was not limited to its own factual circumstance when no individual employee was named as a violator apart from the corporation. *Bennett v. United States Trust Co., supra,* 770 F.2d at 315 (and cases cited therein). Indeed, Intre Sport's argument that section 1962(c) should not be read to require the separation of enterprise and person when the corporation has

actively participated in the fraud was addressed and rejected by the Seventh Circuit in *Haroco v. American Natl. Bank & Trust Co. of Chicago*, 747 F.2d 384 (7th Cir. 1985), *aff'd on other grounds*, ____ U.S. ____, 105 S.Ct. 3291 (1985), a case endorsed by the *Bennett* Court for its construction of section 1962(c):

> The Eleventh Circuit argued in *Hartley* that where the defendant corporation is the central figure in a criminal scheme, as it was in that case, Congress could not have meant to let the perpetrator escape RICO liability while subjecting only the sidekicks to RICO's severe penalties. 678 F.2d at 989. . . . In Parnes, Judge Shadur argued that it would make little sense to hold a corporation liable under RICO for the misconduct of lower level employees, at least where it appears that the corporation is a passive instrument or even a victim of the racketeering activity. 548 F. Supp. at 23-24.
>
> . . .
>
> In our view, the RICO provisions have already taken into account these competing policies in different situations, and a careful parsing of section 1962 reveals a sensible balance among these policies. . . .
>
> In our view, the tensions between these powers may be resolved sensibly and in accord with the language of section 1962 by reading subsection (c) together with subsection (a). As we read subsection (c), the "enterprise" and the "person" must be distinct. However, a corporation-enterprise may

> be held liable under subsection (a) when the corporation is also a perpetrator.[2]

Id. at 401-402.

Further, Intre Sport has not alleged any facts which portray the company as "active perpetrator of the fraud," or which place Kidder, Peabody in the role of "central figure in the criminal scheme." *Id.* at 401. Although the amended complaint calls Brant a "vice president" of the company, Kidder, Peabody states that there are hundreds of such vice presidents at the company who function as registered account representatives and who are not involved in firm management. Furthermore, the amended complaint does not name a single officer at Kidder, Peabody who "aided and abetted" Brant in any of his dealings with Turner and MacLeod.

Many district courts have dismissed strikingly similar claims which name brokerage firms as both "enterprise" and "person" or violator of section 1962 because the plaintiffs could not allege that the firms actively participated in the misconduct of the employee and because the claims could not plead the firms as both "enterprise" and "person" under the statute. *Rush v. Oppenheimer,* No. 84 Civ. 3219 (Dec. ____, 1985 S.D.N.Y.) (Brokerage firm not a proper "person" under § 1962 because not an active participant in account executive's "churning" and not properly named as both "person" and "enterprise"); *Schofield v. First Commodity Corp. of Boston,* No. 83-4137-Z (D.Mass., April 29, 1985) (commodities firm cannot be named as person and enterprise under section 1962 when it did not participate in the commission of the predicate acts); *Dakis ex rel. Dakis Pension Fund v. Chapman,* 574 F. Supp. 757 (N.D.Cal. 1983) (Brokerage firm not actively engaged in the "churning" of employee registered

representative and not properly named as both enterprise and person); *Parnes v. Heinhold Commodities, Inc.*, 548 F. Supp. 20 (N.D.Ill. 1982) (Commodities brokerage firm cannot be named as both person and enterprise under section 1962(c) for its employees' pattern of racketeering activity).

Intre Sport claims that Kidder, Peabody's vicarious liability for the acts of its employee Brant, makes it proper to name the company as a "person" or violator of the predicate criminal acts constituting a pattern of racketeering under section 1962. This argument has, however, been rejected by the majority of courts considering the issue, as it accomplishes an end-run around the required distinction between "enterprise" and violator of the statute, and uses concepts of civil vicarious liability to impute the responsibility for the criminal predicated acts of the employee onto the employer. As the Court stated in *Parnes v. Heinhold Commodities Inc., supra,* 548 F. Supp. at 24 n.9, "that sort of respondeat superior application, perhaps permissible to establish ordinary civil liability would be bizzare indeed as a means to warp the facts alleged in this case into the RICO mold. On that theory malefactors at a low corporate level could thrust treble damages liability on a wholly unwitting corporate management and shareholders." *Accord Rush v. Oppenheimer, supra,* No. 84 Civ. 3219 (Dec. ____, 1985 S.D.N.Y.); *Schofield v. First Commodity Corp. of Boston, supra,* No. 83-4137-Z (April 29, 1985, D.Mass.); *Dakis ex rel Dakis Pension Fund v. Chapman, supra,* 574 F. Supp. at 75; *Haroco v. American National Bank & Trust, supra,* 747 F.2d at 402 n.20 (there is no statutory grounds for asserting that respondeat superior liability differentiates civil from criminal RICO under § 1962(c) permitting a corporation to be both a defendant and enterprise under the statute). *Contra, Bernstein v. I.D.T. Corp.*, 582 F. Supp. 1079 (D.Del. 1984); *Morley v. Cohen,* No. § 83-4198 (D.Md. 1985).

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The same facts which indicate that Kidder, Peabody was not a "central figure" in Brant's alleged frauds would make criminal *respondeat superior* RICO liability for these frauds a "bizzare result" in this case. In short, Kidder, Peabody cannot be named as both "enterprise" and "person" under § 1962(c) and is not a proper defendant in this civil RICO claim. Because Intre Sport has failed to meet this threshold pleading burden, there is no need to reach the question of whether Intre Sport has established a "pattern of racketeering activity."

The 12(2) Claim

Intre Sport also asserts a claim under section 12(2) of the Securities Act of 1933, 15 U.S.C. § 7712, which provides a private civil cause of action against persons who sell or offer to sell unregistered securities on the basis of misleading prospectuses or oral communications. Kidder, Peabody contends that Intre Sport's claim under section 12(2) for negligent untrue statements or omissions in the sale of the American Surgery stock must be dismissed because the claim is time-barred. Section 13, 15 U.S.C. § 77n, which sets the statute of limitations for section 12(2) violations, provides in relevant part: "No action shall be maintained to enforce any liability created under section . . . 771(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence. . ." 15 U.S.C. § 77m. Because this action was filed more than one year after the May, 1983 sale, the question to be resolved is whether Turner and MacLeod should have discovered the allegedly fraudulent misstatements more than one year before the commencement of this action.

A claim under section 12(2) must affirmatively plead compliance with the statute of limitations contained in section

13, and must include a statement of the plaintiff's "due diligence" in seeking discovery of these untruths or omissions. *Hill v. Der,* 521 F. Supp. 1370, 1389 (D.Del. 1981). Kidder, Peabody claims that Intre Sport's pleading of compliance with this statute of limitations is defective as a matter of law, and Intre Sport contends that the question of reasonable diligence is one for the jury.

While the court in *Cook v. Avien, Inc.,* 573 F.2d at 697 n.27 noted that when a question of reasonable diligence arises it is normally for the jury to decide, other courts have acknowledged that "where it is clear that the plaintiffs cannot, as a matter of law, refute the defendant's plea of limitations, summary judgment may be granted." (citations omitted) *Birder v. Merrill Lynch, Pierce, Fenner & Smith,* 644 F.2d 690 (9th Cir. 1981), *see also In Re Caesar's Palace Securities Litigation,* 360 F. Supp. 366, 377 (S.D.N.Y. 1973) (further discovery was required before the court could rule on compliance with the statue of limitations in section 13). While the *Birder* court was determining that this question of fact would not preclude summary judgment in the context of an alleged violation of Rule 10b-5, this rule has been applied without distinction to questions of reasonable diligence in the section 12(2) context. *Hagert v. Glickman, Lurie, Eiger & Co.,* 520 F. Supp. 1028 (D.Minn. 1981) (summary judgment is an appropriate vehicle for determining compliance with the statute of limitations, but summary judgment should be denied where there are issues of fact as to when the limitations period begins). Here there are no disputed facts which need further development, and Intre Sport's own contentions in the amended complaint establish that the statute of limitations bars this claim. *Cf. Freschi v. Grand Coal Venture,* 583 F. Supp. 780 (S.D.N.Y. 1984) (in extreme circumstances summary judgment is appropriate on the question of when the statute of limitations in a § 10(b) action begins to run).

According to Kidder, Peabody, Intre Sport should have been

on notice of Brant's misrepresentations about the American Surgery stock when the company failed to register its stock by the end of 1983, as Brant had promised. Although Intre Sport does not contest that it bases the section 12(2) claim on Brant's alleged promise that the shares would be registered in 1983, Turner and MacLeod contend that this failure to register the stock did not alert them to Brant's alleged fraudulent misrepresentations because Brant engaged in continuing misrepresentations to lull the pair into inaction on their potential section 12(2) claim. According to Intre Sport, Turner and MacLeod fulfilled their "reasonable diligence" requirements by making repeated demands for an explanation from Brant, who met these inquiries with assurances that the failure to register the private placement shares was merely temporary, and that the shares would be registered as soon as the price of the publicly trades shares "stabilized."

To comply with the reasonable diligence standard, Intre Sport must show that it filed suit when the possibility of suit should have become apparent, *Ingenito v. Bermec Corp.*, 441 F. Supp. 525, 554 (S.D.N.Y. 1977) and that it did not engage in "leisurely discovery of the full details of the scheme." *Hill v. Der, supra,* 521 F. Supp. at 1370, *citing Klein v. Bower,* 421 F. 2d 338, 343 (2d Cir. 1970).

As the First Circuit stated in *Cook v. Avien,* 573 F.2d 685, 698 (1st Cir. 1978), "[T]he exercise of reasonable diligence requires an investor to be reasonably cognizant of financial developments relating to his investment, and mandates that early steps be taken to appraise those facts which come to the investor's attention. Although this principle is particularly true when the non-disclosed facts are negligently omitted, even where facts are fraudulently withheld, a plaintiff cannot be allowed to ignore the economic status of his or her investment."

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Intre Sport has failed to demonstrate that it appraised the facts which came to its attention about the American Surgery offering in a timely fashion. There are no factual disputes surrounding this issue. The misrepresentation which forms the basis of the section 12(2) complaint was Brant's alleged promise that by the end of 1983, the privately placed American Surgery stock would be registered and publicly tradeable. Intre Sport admits in its amended complaint that by the end of 1983 Turner and MacLeod knew this promise had been a misrepresentation because none of the shares had been so registered. Intre Sport thus had an obligation to act with reasonable diligence within a year of Brant's obvious failure to fulfill this registration promise.

Intre Sport's belief that the statute of limitations did not begin to run until the April, 1984, *Wall Street Journal* article on Brant's alleged insider trading activities is also unfounded because Turner and MacLeod knew by late 1983 that the American Surgery shares were not registered, and it was this knowledge of the untrue statement or omission which triggered the running of the statute of limitations. The fact that Brant persuaded Turner and MacLeod that "the company fully expected market conditions and the stock price to improve very shortly at which point the company would register the private placement stock" was not concealment of the failure to register the stock in 1983 but was an explicit admission of this misstatement. Intre Sport knew that none of the stock had been registered in 1983, and Brant's urging of a "wait and see" attitude as to the recovery of the stock price was not a concealment or a continuing misrepresentation but was a truthful acknowledgment that his promise that the stock would be fully tradeable by 1983 was false. The strict statute of limitations in section 13 was meant to prevent plaintiffs from delaying action on potential section 12(2) claims as a hedge against the future lack of success of the unregistered shares:

> To hold otherwise would permit the securities acts to be used as havens for speculation and a buffer against any investment loss. When faced with knowledge of a company's serious financial difficulty, an investor cannot be allowed to wait for market increases knowing that if growth does not take place the securities acts will provide the insurance against loss.

Cook v. Avien, supra, 573 F.2d at 698. Because Intre Sport admits that it possessed knowledge of its potential section 12(2) claim in 1983, its section 12(2) claim is time-barred.

Arbitration

Kidder, Peabody has moved for an order requiring Intre Sport to submit its federal securities claims to arbitration based on the signed Customer's Agreement, which calls for arbitration of any and all controversies relating to the account. Kidder, Peabody claims that the Supreme Court's recent opinion in *Dean Witter Reynolds, Inc. v. Byrd,* ____ U.S. ____, 105 S.Ct. 1238 (1985) requires that Intre Sport's agreement to arbitrate be enforced even as to these federal securities claims. Intre Sport contends that the Court's analysis in *Byrd* does not alter current Second Circuit precedent holding federal securities claims non-arbitrable. However, the *Byrd* opinion's strong language casting doubt on the continued non-arbitrability of federal securities law claims, the Supreme Court's renewed vigor in enforcing agreements to arbitrate under the Federal Arbitration Act, and the significant differences between the implied private rights of action under the 1934 Act and the 1933 Act sections held non-arbitrable by the Supreme Court, I require that these federal securities claims must be referred to arbitration.[3]

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The Federal Arbitration Act, 9 U.S.C. § 1 *et seq,* mandates that a federal or state court compel arbitration whenever the controversy at bar is referrable to arbitration under a contract "involving commerce," a fact which both parties concede in this action. Section 2 of the Act sets the standards for the enforceability of arbitration agreements:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by Arbitration a controversy thereafter arising out of such contract of transaction or the refusal to perform the whole or parth thereof, or an agreement in writing to submit to Arbitration an existing controversy arising out of such a contract, transaction or refusal, shall be valid, irrevocable, and enforceable, ____ upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2. As the Supreme Court stated in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.,* 460 U.S. 1, 22 n.27 (1983), the federal courts are obliged to grant a stay and order arbitration when the subject matter of the suit is referrable to arbitration, and the party applying for the stay is not in default in proceeding to such arbitration.

Intre Sport insists that federal securities law claims are exempted from the scope of the Federal Arbitration Act, and that the Supreme Court's opinion in *Dean Witter Reynolds, Inc. v. Byrd, supra,* 105 S.Ct. 1238 (1985) does not alter this non-arbitrability. Intre Sport's position that 10(b) and 15(c) claims are non-arbitrable was the prevailing law of the Second Circuit prior to *Byrd.* In *Wilko v. Swan,* 346 U.S. 427 (1953) the Supreme

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Court held that an agreement to arbitrate disputes arising from a broker-dealer relationship cannot include arbitration of the plaintiff's 1933 Act Claim because enforcement of that arbitration agreement would contravene the anti-waiver provisions of section 14 of the Securities Act of 1933. The Second Circuit, noting the strong policy in favor of resolving federal securities fraud questions in the federal courts, extended the *Wilko* doctrine to prevent compulsory arbitration of claims under section 10(b) of the 1934 Act. *Greater Continental Corp. v. Schechter,* 422 F.2d 1100, 1103 (2d Cir. 1970).

However, *Dean Witter Reynolds, Inc. v. Byrd, supra,* 105 S.Ct. 1238 (1985), considered in conjunction with collateral developments restricting federal statutory exemptions from compulsory arbitration, dramatically alters the presumption of non-arbitrability of section 1934 claims.

In *Byrd*, the Supreme Court upheld the right of a brokerage firm to arbitrate the common law fraud claims of the plaintiff, despite the fact that they were "intertwined" with the plaintiff's non-arbitrable federal securities claims. While the Court declined to determine whether the plaintiff's section 10(b) claim was arbitrable, as it was not properly before the court, both the majority opinion and in particular Justice White's concurring opinion, cast doubt on the continued applicability of the *Wilko* doctrine to claims arising under the 1934 Act:

> The premise of the controversy before us is that respondent's claims under the Securities Exchange Act of 1934 are not arbitrable, notwithstanding the contrary agreement of the parties. This court's opinion rightly concludes that the question whether that is so is not before us. *Ante,* at 1, n.1.

> Nonetheless, I note that this is a matter of substantial doubt." *Id.* at 4225.

Justice White's *Byrd* analysis consisted of a comparison between the three statutory sections of the 1933 Act upon which the Court based its *Wilko* opinion, and their analogous sections in the 1934 Act, and concluded that "Wilko's reasoning cannot be mechanically transplanted to the 1934 Act." *Id.* The Court in *Wilko* based the non-arbitrability of the section 12(2) 1933 Act claim on: 1) the existence of § 14 of the Act, the non-waiver provision; 2) section 12(2) of the Act, and its creation of a "special right to recover for misrepresentations which differs substantially from the common law action," and; 3) section 22 which provides concurrent state and federal jurisdiction for 1933 Act claims. *Wilko v. Swan,* 346 U.S. at 434-436; 15 U.S.C. § 77n, 77l(2), 77v. Justice White, observing that only one of these provisions, the non-waiver clause, has a 1934 Act counterpart in section 29(a), 15 U.S.C. § 78cc(a), reiterated the Supreme Court's reasoning in *Scherk v. Alberto-Culver Co.,* 417 U.S. 506, 513-14 (1974) where the Court first expressed reservations about extending the *Wilko* doctrine to 1934 Act claims:

> Wilko's reasoning cannot be mechanically transplanted to the 1934 Act. While § 29 of the Act, 15 U.S.C. § 78cc(a), is equivalent to § 14 of the 1933 Act, counterparts of the other two provisions are imperfect or absent altogether. Jurisdiction under the 1934 Act is narrower, being restricted to the federal courts. 15 U.S.C. § 77aa. More important, the cause of action under § 10(b) and Rule 10b-5, involved here, is implied rather than express. See *Herman & MacLean v. Huddleston,* 459 U.S. 375, 380 and nn. 9-10 (1983).

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> The phrase "waive compliance with any provision of this chapter." 15 U.S.C. § 78cc(a) (emphasis added) is thus literally inapplicable. Moreover, Wilko's solicitude for the federal cause of action—the "special right" established by Congress, 346 U.S. at 431—is not necessarily appropriate where the cause of action is judicially implied and not so different from the common law action.

Id. at 4225.

On the basis of this analysis that the 1934 Act did not contain the statutory indications for special exemption from the reach of the Federal Arbitration Act, Justice White concluded that "the contrary holdings of the lower courts must be viewed with some doubt." *Id.*

Intre Sport contends that the private causes of action implied under the fraud provisions of the 1934 Act are different from the common law fraud remedies available prior to its enactment, and that they deserve the same solicitude as the *Wilko* Court extended to 1933 Act claims. To support this contention, Intre Sport points to the Court's opinion in *Herman & MacLean v. Huddleston,* 459 U.S. 375 (1983), which recognizes that "the antifraud provisions of the securities laws are not co-extensive with common-law doctrines of fraud. Indeed, an important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry." *Id.* at 388-89. According to Intre Sport, there is no reason to have a lesser right to bring a cause of action implied from the statute rather than one specified in the statute.

However, this line of argument ignores the jurisprudential context of the *Byrd* opinion. The Court's observation that the anti-waiver provisions in section 29(a) do not extend to the implied rights of action under section 10(b) are significant because of the Supreme Court's recent attempt to make federal statutory causes of action arbitrable absent express Congressional intent to remove them from arbitration. This renewed emphasis on the paramount importance of the Federal Arbitration Act is evident in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp., supra,* 460 U.S. at 24-25, where the Court stated: "Section 2 is a congressional declaration of a liberal federal policy favoring arbitration of agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." . . . "The arbitration act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *See also Development Bank of the Phillipines v. Chemex Fibers, Inc.,* No. 85 Civ. 1939 (per Weinfeld, J.) (Sept. 11, 1985, S.D.N.Y.) (the Supreme Court has stressed that the Federal Arbitration Act establishes a strong preference for arbitration, which is to be given presumptive effect in doubtful cases).

The Court's recent opinion in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.,* ____ U.S. ____, 53 U.S.L.W. 5069 (July 1, 1985) demonstrates this renewed commitment to the arbitrability of statutory claims. In *Mitsubishi,* the Supreme Court held that federal antitrust claims in the international context are fully arbitrable and enjoy no blanket or presumptive immunity from arbitration. The Court's explanation of how to construe

the Federal Arbitration Act illustrates the weakness of Intre Sport's argument that even implied federal securities claims should be considered non-waivable under section 29(a) and should come under the rationale of *Wilko*:

> Just as it is the congressional policy manifested in the Federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by the Act, it is the Congressional intent expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable . . . we must assume that, if Congress intended the substantive protection afforded by a given statute to include protection against the waiver of a right to a judicial forum, that intention will be deducible from text or legislative history. . ."

53 U.S.L.W. at 5073.

Thus, the Supreme Court's emphasis on the requirement that Congress specify which federal statutory claims are outside the scope of the Federal Arbitration Act is inconsistent with Intre Sport's belief that the *Wilko* doctrine should be extended to exempt even implied causes of action under the federal securities law, dispite the fact that these remedies are not explicitly within the non-waiver provisions of the 1934 Act. This court joins the growing list of district courts which have interpreted the *Byrd* decision as a mandate for the arbitrability of 10(b) claims. *See e.g., Dees v. Smith Barney, Harris Upham & Co.*, No. 848676-PAR (July 31, 1985, C.D.Cal.); *Bateh v. Prudential Bache Securities, Inc., et a.*, No. 84-526-Civ-J-14 (July 29, 1985, M.D.Fla.); *Sevinor v.*

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Merrill Lynch, Pierce, Fenner & Smith, et al., No. 84-3240-N (July 19, 1985, D.Mass.); *Finn v. Prudential-Bache Securities*, No. 84-8414-Civ.-Gonzalez (June 20, 1985, S.D.Fla.); *Coonly v. Rotan Mosle, Inc., et al.*, No. A-83-CA-529 (June 4, 1985, W.D.Tex.); and *Johnson v. Kidder, Peabody & Co., et al.*, No. 85-CV-178 (July 30, 1985, N.D.N.Y.), *but see Jacobson v. Merrill Lynch, Pierce Fenner & Smith, et al.*, No. 84-1844 (April 22, 1985, W.D.Pa.); *Luce v. Edelstein*, [current] Fed.Sec.L.Rep. (CCH) ¶92,258 (____ 1985 ____, S.D.N.Y.) (Retaining jurisdiction over 10(b) claim without reference to *Byrd*).

On the basis of the foregoing analysis, I hold that Intre Sport is required to submit both its common law fraud and 1934 Act claims to arbitration, pursuant to the Kidder, Peabody Customer's Agreement. Because Intre Sport's 12(2) claim is barred by the statute of limitations, and its RICO claim is improperly pleaded, this action is hereby dismissed.

IT IS SO ORDERED.

DATED: New York, N.Y.
December 23, 1985

s/ Sweet
ROBERT W. SWEET
U.S.D.J.

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FOOTNOTES

1. An "enterprise" under section 1961(4) includes an individual, partnership, corporation, association, or any other legal entity, and any union or group of individuals associated in fact nor not a legal entity.

2. Section 1962(a), a claim which Intre Sport has not alleged against Brant but against Kidder, Peabody, provides in relevant part:

> **§ 1962. Prohibited activities**
>
> (a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern or racketeering activity or the

collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

3. Although the cases discussed herein do not explicitly refer to section 15 of the 1934 Act, both parties agree that the arbitrability of this claim is governed by the same principles which govern arbitrability of section 10(b) claims.

APPENDIX C—ORDER OF SUMMARY AFFIRMANCE BY THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

86-7325

INTRE SPORT,

Plaintiff,

v.

KIDDER,

Defendant.

NOTICE OF MOTION FOR SUMMARY AFFIRMANCE

MOTION BY:

Matthew Farley, Esq.
Shanley & Fisher, P.C.
400 Park Avenue, 11th Fl., Suite 1100
New York, New York 10022
(212) 759-6586

OPPOSING COUNSEL:

William J. Foster, IV, Esq.
Rogers, Hoge & Hills
90 Park Avenue
New York, New York 10016
(212) 953-9200

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Has consent of opposing counsel:

A. been sought? ☒ Yes ☐ No

B. been obtained? ☒ Yes ☐ No

Has service been effected? ☒ Yes ☐ No

Is oral argument desired? ☐ Yes ☒ No

Requested return date: June 10, 1986

Has argument date of appeal been set:

A. by scheduling order? ☒ Yes ☐ No

B. by firm date of argument notice? ☐ Yes ☒ No

C. If *Yes,* enter date: Week of August 11, 1986

Judge or agency whose order is being appealed: The Honorable Robert W. Sweet, U.S.D.J.

EMERGENCY MOTIONS, MOTIONS FOR STAYS & INJUNCTIONS PENDING APPEAL

Has request for relief been made below? ☐ Yes ☒ No
(See F.R.A.P. Rule 8)

Brief statement of the relief requested: Summary affirmance

By: s/ Matthew Farley
Matthew Farley

Appendix C

Appearing for: Kidder, Peabody & Co. Inc.

Appellant or Petitioner: ☐ Plaintiff ☒ Defendant

Appellee or Respondent: ☒ Plaintiff ☐ Defendant

Date May 28, 1986

ORDER

Before: Hon. THOMAS J. MESKILL, Hon. AMALYA L. KEARSE, Hon. GEORGE C. PRATT, C.J.J.

IT IS HEREBY ORDERED that the motion be and it hereby is *granted.*

FOR THE COURT:

Elaine B. Goldsmith, Clerk

By: s/ Edward J. Guardaro

June 17, 1986 Edward J. Guardaro, Deputy Clerk

APPENDIX D—OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT IN *AFP IMAGING CORP V. ROSS*

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Cal. No. 175—August Term, 1985

(Argued October 9, 1985 Decided December 23, 1985)

Docket No. 85-7494

AFP IMAGING CORPORATION,

Plaintiff-Appellant,

—v.—

ALEXANDER ROSS, JAMES L. MELCHER, IVAN BLOCH, VINCENT GIOVINCO, BRUCE MALE, FREDERICK M. MYERS, JOHN C. FITCH, and LEWIS W. SIEGEL, Individually and as representative of all others similarly situated,

Defendants-Appellees.

Before:

FEINBERG, *Chief Judge*,
VAN GRAAFEILAND and MESKILL, *Circuit Judges.*

Appeal from a summary judgment of the United States District Court for the Southern District of New York

(Brieant, J.) which dismissed a Count alleging securities fraud and ordered arbitration of two common law claims. Dismissal of securities fraud Count reversed and matter remanded to the district court for further proceedings. Direction to arbitrate affirmed in part and vacated in part without prejudice.

STUART A. SUMMIT, New York, N.Y. (Burns Summit Rovins & Feldesman, New York, N.Y. of Counsel), *for Plaintiff-Appellant.*

LEO KAYSER, III, New York, N.Y. (Raggio, Jaffe & Kayser, New York, N.Y., of Counsel), *for Defendant-Appellees.*

ANTHONY E. DAVIS, New York, N.Y. (Kaplan Russin Vecci Kirkwood, New York, N.Y., of Counsel), *for Defendant-Appellee Alexander Ross.*

VAN GRAAFEILAND, *Circuit Judge*:

AFP Imaging Corporation appeals from a summary judgment of the United States District Court for the Southern District of New York (Brieant, J.). The judgment dismissed Count I of AFP's partial-defendant class action complaint, which alleges violation of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.

§ 78j(b), and Rule 10b-5 of the Securities & Exchange Commission's Rules, 17 C.F.R. § 240.10b-5, and directed arbitration of the remaining issues between the parties. For the reasons that follow, we reverse the part of the judgment that dismissed the securities fraud claim, affirm the part that ordered arbitration of the claim of appellant Ross, and vacate and remand the remainder of the judgment without prejudice.

AFP and Xenon Industries, Inc. are New York corporations. The members of the putative defendant class are the twenty-nine shareholders of Xenon. On August 8, 1984, AFP and Xenon executed a written contract, which provided, among other things, that Xenon would "cause the sale" of all the shares of its capital stock to AFP and would transfer all the shares to AFP on the closing date "duly endorsed for transfer". The agreed consideration for this sale was 225,000 letter shares of AFP stock plus warrants for an additional 400,000 shares. AFP now seeks to hold Xenon's shareholders responsible under both the securities laws and the common law for alleged fraudulent misrepresentations in the written contract. It demands the return of its stock, damages, and certain incidental relief.

Although the contract described Xenon as the "seller" of its stock, the district court stated that Xenon was not the seller and that it was appellees who sold their stock pursuant to the contract. We agree. New York follows the majority American rule, which treats shares of stock as the personal property of the shareholders. *Allen v. Biltmore Tissue Corp.*, 2 N.Y.2d 534, 540-41 (1957). Obviously, a New York corporation, acting solely on its own, cannot "cause" the sale of all its corporate shares for a consideration fixed by the corporation.

There is no reason, however, why Xenon could not have acted as appellees' agent in effecting the sale of their stock. Although, ordinarily, a corporation does not act in the capacity of agent for its shareholders, *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 440 (1943), the shareholders may involve the corporation in their own business affairs to such an extent as to constitute it their agent. *Hollander v. Henry*, 186 F.2d 582, 584 (2d Cir.), *cert. denied*, 341 U.S. 949 (1951); *Walkovszky v. Carlton*, 18 N.Y.2d 414, 417 (1966); *Rapid Transit Subway Construction Co. v. City of New York*, 259 N.Y. 472, 488 (1932). A jury well might find that this is what occurred in the instant case.

Because Xenon was not the seller and could not unilaterally effect the sale of its own stock, a jury might conclude that Xenon was acting in some sort of representative capacity for appellees, who were the sellers and who clearly benefited from Xenon's acts. Moreover, it is undisputed that appellees accepted those benefits with full knowledge of the warranties and representations contained in the written contract of sale. Each appellee was required to execute and deliver to AFP an "Investment Representation Letter", in which he acknowledged that he had received and reviewed a copy of the contract. We conclude from the foregoing that this case presents factual issues concerning apparent and implied authority, authority by estoppel, and ratification, that do not lend themselves to summary disposition. *See Hedeman v. Fairbanks, Morse & Co.*, 286 N.Y. 240, 248-49 (1941); *Cavic v. Grand Bahama Development Co.*, 701 F.2d 879, 887 n.4 (11th Cir. 1983); *Songbird Jet Ltd. v. Amax Inc.*, 581 F. Supp. 912, 920 (S.D.N.Y. 1984); *Cullen v. BMW of North America, Inc.*, 490 F. Supp. 249, 252-54 (E.D.N.Y.

1980). If, in fact, Xenon was acting as appellees' agent in making what AFP alleges to be false warranties and representations, appellees, having accepted the benefits with knowledge of the inducements, will be hard put to disassociate themselves from Xenon's allegedly wrongful acts. *See American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp.*, 456 U.S. 556, 565-70 (1982); *Weitnauer Trading Co. v. Annis*, 516 F.2d 878, 880 (2d Cir. 1975); *Radiation Dynamics, Inc. v. Goldmuntz*, 323 F. Supp. 1097, 1099 (S.D.N.Y. 1971), *aff'd*, 464 F.2d 876 (2d Cir. 1972).

Because of AFP's concession that it is relying on only the representations in the written contract, there is no need to comment on the district court's discussion concerning possible unwritten representations. Because we are reversing the district court's dismissal of the federal securities law claim, we likewise need not address AFP's argument that, as a result of the dismissal, the district court lost pendent jurisdiction to order arbitration. Finally, we agree with appellees that the district court's cursory reference to limitation of liability did not create an issue for this Court to consider. The district court, having found no liability, never reached the question whether a recovery by AFP would be limited to an escrow fund containing AFP stock, which was set up pursuant to the terms of the contract.

Although the contract provided that all controversies arising under or in connection with it would be settled by arbitration, this provision is, of course, unenforceable under the law of this Circuit insofar as the securities law claim is concerned. *Greater Continental Corp. v. Schechter*, 422 F.2d 1100, 1103 (2d Cir. 1970). *Cf. Dean Witter Reynolds, Inc. v. Byrd*, 105 S. Ct. 1238, 1240 n.1 (1985),

indicating that the Supreme Court considers this an open question. However, appellee Ross has a common law breach of contract claim against AFP, which is arbitrable. The contract of sale provided in substance that, as part of the deal, AFP and Ross would execute a three-year employment agreement upon terms and conditions acceptable to Ross. The agreement never was executed, but Ross went to work for AFP anyway and was discharged after he had been employed for less than six months. When AFP brought the instant action, Ross promptly demanded arbitration of his claim. AFP then sought an order staying the arbitration and directing Ross to assert his claim as a counterclaim in the action. The district court had no alternative but to deny this relief. *Dean Witter Reynolds, Inc. v. Byrd, supra*, 105 S. Ct. at 1241-42; *NPS Communications, Inc. v. Continental Group, Inc.*, 760 F.2d 463, 465-66 (2d Cir. 1985).

Because of the Supreme Court's unequivocal language in *Dean Witter, supra*, the district court also was bound to grant appellees' request for arbitration of AFP's claim of common law fraud. However, because AFP's counsel has assured this Court that, if the securities claim is remanded to the district court, AFP will withdraw its state law claim for fraud, we think it will simplify procedures if, instead of affirming, we vacate the part of the district court's judgment that orders arbitration of the state law claim, without prejudice to its immediate reinstatement if, upon remand, AFP fails to withdraw that claim promptly.

In summary, the decision and order of this Court is as follows:

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1. The part of the district court's judgment that dismisses Count I of the complaint is reversed, and the issues alleged in that Count are remanded to the district court for further proceedings consistent with this opinion.

2. The part of the judgment that orders arbitration of the common law breach of contract claim of appellee Ross is affirmed.

3. The part of the judgment that orders arbitration of AFP's state law claim and enjoins litigation of this claim is vacated without prejudice to its reinstatement should AFP fail to withdraw this claim promptly upon remand.

APPENDIX E—OPINION OF UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT IN *McMAHON V. SHEARSON/AMERICAN EXPRESS, INC.*

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 806, 894—August Term 1985

(Argued March 3, 1986 Decided April 16, 1986)

Docket Nos. 85-7844, 85-7846

EUGENE MCMAHON, JULIA MCMAHON, individually and as Trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Plaintiffs-Appellants-Cross-Appellees,

—v.—

SHEARSON/AMERICAN EXPRESS, INC., and MARY ANN MCNULTY,

Defendants-Appellees-Cross-Appellants.

Appendix E

Before:

FEINBERG, *Chief Judge*,
and TIMBERS and NEWMAN, *Circuit Judges*.

Appeal from an order entered September 25, 1985 in the Southern District of New York, Lloyd F. MacMahon, *District Judge*, requiring broker's customers to arbitrate claims under the Securities Exchange Act of 1934 and pendent state law claims pursuant to customer agreements containing an arbitration clause, and staying litigation of an alleged RICO violation claim pending arbitration.

Affirmed in part; reversed and remanded in part.

THEODORE G. EPPENSTEIN, New York, N.Y. (Madelaine Eppenstein, and Eppenstein & Eppenstein, New York, N.Y., on the brief), *for appellants*.

THEODORE A. KREBSBACH, New York, N.Y. (Harry D. Frisch and Shearson Lehman Brothers Inc., New York, N.Y., on the brief), *for appellees*.

WILLIAM J. FITZPATRICK and GERARD J. QUINN, New York, N.Y., submitted a brief *for the Securities Industry Association, Inc., amicus curiae*.

Appendix E

TIMBERS, *Circuit Judge*:

Eugene McMahon and Julia A. McMahon ("appellants"), individually and as trustees for various pension and profit-sharing plans, appeal from that part of an order entered September 25, 1985 in the Southern District of New York, Lloyd F. MacMahon, *District Judge*, 618 F. Supp. 384, which required appellants to arbitrate their claims against Shearson/American Express, Inc. and its registered representative, Mary Ann McNulty, ("Shearson") for alleged violations of the Securities Exchange Act of 1934 ("1934 Act") and state law claims of fraud and breach of fiduciary duties. Shearson appeals from that part of the order holding not arbitrable appellants' claim under the Racketeer Influenced Corrupt Organizations Act, 18 U.S.C. § 1962(c) (1982) ("RICO"). The district court stayed litigation of the RICO claim pending arbitration of the securities law and state law claims.

For the reasons set forth more fully below, under the settled law of this Circuit we hold that the district court erred in holding arbitrable appellants' claims under § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1985). The district court, however, was correct in holding the RICO claim to be non-arbitrable. Applying the decision of the Supreme Court in *Dean Witter Reynolds, Inc.* v. *Byrd*, 105 S. Ct. 1238 (1985), we hold that arbitration of the pendent state law claims is required, even though bifurcated proceedings may result.

In short, we affirm in part, and reverse and remand in part.

Appendix E

I.

The facts and prior proceedings are simple and straightforward.

Appellants, individually and as trustees for various pension and profit-sharing plans, commenced this action against Shearson, a brokerage firm, and its registered representative who handled appellants' accounts. Appellants alleged that the registered representative of Shearson, with its knowledge, had violated § 10(b) of the 1934 Act and Rule 10b-5 by churning appellants' accounts, making false statements and omitting material facts from the advice given appellants. Appellants also alleged a RICO claim and state law claims for fraud and breach of fiduciary duties.

On June 15, 1982 Julia McMahon entered into a customer agreement with Shearson which contained an arbitration clause providing in relevant part as follows:

> "Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I may elect."

Relying on this clause, Shearson moved, pursuant to § 3 of the United States Arbitration Act, 9 U.S.C. § 3 (1982), to compel arbitration of all of appellants' claims. In the alternative, Shearson moved to dismiss the complaint for failure to state a claim upon which relief could be granted and on other grounds, none of which is relevant in view

of the district court's disposition of the motion to compel arbitration.

The district court rejected appellants' assertions that the customer agreement containing the arbitration clause is a contract of adhesion, that fraud is not an arbitrable issue, and that Shearson had waived its right to arbitrate. The court ordered arbitration of the § 10(b) and Rule 10b-5 claims, reasoning that recent Supreme Court decisions cast doubt on holding claims under the 1934 Act to be not arbitrable. In view of the important federal policies inherent in the enforcement of RICO by the federal courts, however, the court stayed litigation of that claim pending arbitration. The court ordered arbitration of the state law claims.

We shall examine first the district court's decision that the claims under § 10(b) and Rule 10b-5 are arbitrable. We shall then address the arbitrability of the RICO claim and state law claims.

II.

We turn first to the district court's disposition of appellants' 1934 Act claims.

We hold that the district court's decision that appellants' claims under § 10(b) and Rule 10b-5 are arbitrable is an unwarranted departure from the settled law of this Circuit and must be reversed.

In *Wilko* v. *Swan*, 346 U.S. 427 (1953), the Supreme Court held that, despite the United States Arbitration Act, 9 U.S.C. § 1 *et seq.*, claims arising under § 12(2) of the Securities Act of 1933 ("1933 Act") are not arbitrable. In reaching this result, the Court pointed out that an agreement to arbitrate claims is void under § 14 of the

1933 Act as a stipulation binding the securities customer to waive compliance with a provision of the Act.[1] The provision referred to is the aggrieved party's right to select the judicial forum under § 22(a) of the 1933 Act.

As our late colleague, Judge Friendly, noted in *Colonial Realty* v. *Bache & Co.*, 358 F.2d 178, 183 n.5 (2 Cir.), *cert. denied*, 385 U.S. 817 (1966), the non-waiver provision of § 14 of the 1933 Act has an almost identical counterpart in § 29(a) of the 1934 Act.[2] In view of *Wilko* and the similarity of the non-waiver provisions of the 1933 and 1934 Acts, we consistently have held that § 10(b) and Rule 10b-5 claims are not arbitrable.[3] In *Greater Continental Corp.* v. *Schechter*, 422 F.2d 1100, 1103 (2 Cir. 1970), we observed that alleged violations of Rule 10b-5 were "properly litigated in the courts where a

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1. Section 14 of the Securities Act of 1933, 15 U.S.C. § 77n (1982), provides:

> "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."

2. Section 29(a) of the Securities Act of 1934, 15 U.S.C. § 78cc(a) (1982), provides:

> "Any condition, stipulation or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

3. Following *Wilko*, several other courts of appeals likewise have held that claims arising under the 1934 Act are not arbitrable. *E.g.*, *De Lancie* v. *Birr, Wilson & Co.*, 648 F.2d 1255, 1258-59 (9 Cir. 1981); *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1039 (6 Cir. 1979); *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Moore*, 590 F.2d 823, 827-29 (10 Cir. 1978); *Weissbuch* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 833-35 (7 Cir. 1977); *Sibley* v. *Tandy Corp.*, 543 F.2d 540, 543 (5 Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); *Ayres* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 (3 Cir.), *cert. denied*, 429 U.S. 1010 (1976).

complete record is kept of the proceedings and findings and conclusions are made." We also pointed out the similarity between § 14 of the 1933 Act and § 29(a) of the 1934 Act. *Id.* In *Allegaert* v. *Perot*, 548 F.2d 432, 436-38 (2 Cir.), *cert. denied*, 432 U.S. 910 (1977), we reiterated the view that claims under § 10(b) of the 1934 Act are not arbitrable, noting that the broad policy questions involved in securities law claims require a judicial forum for resolution of disputes. Again in *AFP Imaging Corp.* v. *Ross*, 780 F.2d 202, 205 (2 Cir. 1985), we held that, in an action which alleged violations of § 10(b) and Rule 10b-5, an arbitration clause in the contract was "unenforceable under the law of this Circuit".

Despite the settled law of this Circuit that claims under § 10(b) and Rule 10b-5 of the 1934 Act are not arbitrable, Shearson, speculating as to what the Supreme Court may do with our settled law, invites us to overrule our own precedents. We decline the invitation.

The district court, in addition to emphasizing the strong national policy favoring arbitration, focused on the Supreme Court's decisions in *Dean Witter Reynolds, Inc.* v. *Byrd*, 105 S. Ct. 1238 (1985), and *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506 (1974). In *Byrd*, since the securities broker had sought to compel arbitration of only pendent state claims—not claims arising under the 1934 Act—the Court declined to reach the issue of whether § 10(b) and Rule 10b-5 claims are arbitrable. 105 S. Ct. at 1240 n.1. Nevertheless, various courts, in holding that § 10(b) and Rule 10b-5 claims are arbitrable, have sought refuge in Justice White's concurring opinion in *Byrd*, 105 S. Ct. at 1244. Justice White stated that *Wilko's* reasoning cannot be "mechanically transplanted" to the 1934 Act. *Id.* While acknowledging the similarity

between § 14 of the 1933 Act and § 29(a) of the 1934 Act. Justice White reasoned that the narrower jurisdiction under the 1934 Act and the implied, rather than express, causes of action under § 10(b) and Rule 10b-5 distinguished claims under the 1934 Act from those arising under the 1933 Act. *Id.* Both the *Byrd* majority and Justice White's concurring opinion acknowledged that *Scherk* v. *Alberto-Culver Co.*, *supra*, 417 U.S. at 513-15, cast some doubt on the applicability of *Wilko* to claims under § 10(b) or Rule 10b-5. 105 S. Ct. at 1240 n.1; 105 S. Ct. at 1244.[4] The Supreme Court in *Byrd*, however, referred to the *Scherk* decision as follows:

> "The [*Scherk*] Court did not, however, hold that *Wilko* would not apply in the context of a § 10(b) or Rule 10b-5 claim, and *Wilko* has retained considerable vitality in the lower federal courts. Indeed, numerous District Courts and Courts of Appeals have held that the *Wilko* analysis applies to claims arising under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and that agreements to arbitrate such claims are therefore unenforceable."

105 S. Ct. at 1240 n.1. (Citations omitted, being among those included in note 3, *supra*).

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4. Indeed, some courts within this Circuit have interpreted dicta in *Scherk* and *Byrd* as authority for holding such claims to be arbitrable. *E.g.*, *Intre Sport Ltd.* v. *Kidder, Peabody & Co.*, 625 F. Supp. 1303 (S.D.N.Y. 1985); *Finkle & Ross* v. *A.G. Becker Paribas, Inc.*, 622 F. Supp. 1505 (S.D.N.Y. 1985); *Jarvis* v. *Dean Witter Reynolds, Inc.*, 614 F. Supp. 1146 (D. Vt. 1985); *Brener* v. *Becker Paribas, Inc.*, 84 Civ. 5872 (S.D.N.Y. Dec. 31, 1985); *Ilan* v. *Shearson/American Express, Inc.*, 83 Civ. 9319 (S.D.N.Y. Dec. 23, 1985); *Johnson* v. *Kidder, Peabody & Co.*, 85 Civ. 178 (N.D.N.Y. July 30, 1985).

Other courts have continued to follow the settled law of this Circuit, holding claims under § 10(b) and Rule 10b-5 not arbitrable. *E.g.*, *Leone* v. *Advest, Inc.*, 624 F. Supp. 297 (S.D.N.Y. 1985); *Weizman* v. *Adornato*, 84 Civ. 3603 (E.D.N.Y. April 25, 1985).

Appendix E

In the instant case, the district court focused on the allegations of churning and misrepresentation centered on particular securities accounts and held inapplicable the broad policy concerns which this Circuit has recognized in holding 1934 Act claims not arbitrable. While a churning claim by its nature is limited to the specific accounts in question, such claims also reflect the public interest and are important in their deterrent effect. The securities laws generally, and the implied causes of action which the courts have recognized, are designed to protect the public, and particularly the less sophisticated investor. Moreover, this Circuit has not recognized an exception to the non-arbitrability of securities law claims in circumstances other than disputes between member firms of the stock exchanges. *E.g.*, *Coenen* v. *R. W. Pressprich & Co.*, 453 F.2d 1209 (2 Cir.), *cert. denied*, 406 U.S. 949 (1972); *Axelrod & Co.* v. *Kordich, Victor & Neufeld*, 451 F.2d 838 (2 Cir. 1971). We see no justification for carving out an exception to our non-arbitrability precedents for individual claims of churning and misrepresentation.

In short, the similarity of the non-waiver provisions, § 14 of the 1933 Act and § 29(a) of the 1934 Act, as well as the strong public policy concerns inherent in the securities laws and the legislative history that preceded their enactment, support the compelling need for a judicial forum in the resolution of securities law disputes. Although *Scherk* and *Byrd* may cast some doubt on whether the Supreme Court, if presented with the issue, would hold claims under § 10(b) and Rule 10b-5 to be non-arbitrable, it would be improvident for us to disregard clear judicial precedent in this Circuit based on mere speculation. We think that the orderly administration of justice will be best served if we as one of the inferior

courts follow Supreme Court precedent and adhere to the settled law of this Circuit, and a fortiori the district courts should do likewise.

III.

We turn next to the district court's disposition of appellants' RICO claim.

Pointing to the important federal policies inherent in the enforcement of RICO by the federal courts, the district court stayed litigation of the RICO claim pending arbitration of the state law claims and the securities law claims. The RICO claim was thus placed on the suspense docket pending the outcome of arbitration of the other claims.

In other contexts, we have recognized the inappropriateness of the United States Arbitration Act when strong public policy considerations are involved. In *American Safety Equipment* v. *J.P. Maguire* 391 F.2d 821 (2 Cir. 1968), we stated that "[a] claim under the antitrust laws is not merely a private matter. The Sherman Act is designed to promote the national interest in a competitive economy; thus, the plaintiff asserting his rights under the Act has been likened to a private attorney-general who protects the public's interest." 391 F.2d at 826. We hold that there are comparable concerns inherent in the enforcement of RICO claims.

The Supreme Court has recognized that arbitration is appropriate in *international* antitrust disputes because of concerns for international comity, respect for the capacities of foreign and transnational tribunals, and the need for predictability in the international commercial system. *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth,*

Inc., 105 S. Ct. 3346 (1985). The reasoning of our decision in *American Safety*, however was not disputed in *Mitsubishi*, "as applied to agreements to arbitrate arising from domestic transactions." 105 S. Ct. at 3355. Enforcement of the RICO statute is particularly appropriate in a judicial forum because of strong policy concerns, the need for development of the record, and judicial clarification and resulting consistency in resolving disputes under this relatively new statute.

The district court had placed the RICO claim on the suspense docket because the arbitrable claims "permeate the case, and the validity of the RICO claim is uncertain at this stage of the litigation." 618 F. Supp. at 389. Since we have held that the securities law claims are not arbitrable, it is now appropriate that the securities law and RICO claims be litigated together since they arise out of the same transaction.[5]

IV.

Finally, this brings us to the district court's disposition of appellants' pendent state law claims.

In addition to the claims that Shearson had violated § 10(b), Rule 10b-5, and RICO, appellants' amended complaint alleged state law claims for common law fraud and breach of fiduciary duties. The district court granted Shearson's motion to compel arbitration of these pendent state law claims as well as the securities law claims.

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5. Appellants suggest that the district court's denial of arbitration of the RICO claim was not an appealable interlocutory order under 28 U.S.C. § 1292(a) (1982). We disagree. *See Ettelson* v. *Metropolitan Life Insurance Co.*, 317 U.S. 188, 191 (1942); *Enelow* v. *New York Life Insurance Co.*, 293 U.S. 379, 383 (1935); *Poriss* v. *Aacon Auto Transport, Inc.*, 685 F.2d 56, 59-60 (2 Cir. 1982).

Under the Supreme Court's decision in *Dean Witter Reynolds, Inc.* v. *Byrd, supra*, these state law claims must be sent to arbitration where there is an enforceable arbitration clause and where a party's motion to compel arbitration encompasses the state law claims, as here.[6] *See also AFP Imaging Corp.* v. *Ross, supra*, 780 F.2d at 205. The Court's language in *Byrd* is unequivocal.

> "[T]he Arbitration Act requires district courts to compel arbitration of pendent arbitrable claims when one of the parties files a motion to compel, even where the result would be the possibly inefficient maintenance of separate proceedings in different forums."

105 S. Ct. at 1241. The Court also recognized that such bifurcated proceedings could result where securities or antitrust violations are alleged. 105 S. Ct. at 1241 n.5. We hold that the district court correctly held that the pendent state claims were arbitrable. Despite the potential inefficiency of bifurcated proceedings, we are obliged under *Byrd* to affirm that part of the district court's order compelling arbitration of the pendent state law claims.[7]

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6. Appellants challenge the arbitrability of their claims against Shearson on numerous grounds. In view of our rulings on the securities and RICO claims, these arguments are not relevant to the litigation of the disputes under federal law but they do require brief examination since, generally, state law claims for fraud and breach of fiduciary duties are arbitrable if there is a valid arbitration clause. In the instant case, the district court found that the elements for compelling arbitration were present, *i.e.*, an agreement to arbitrate, arbitrable claims, and the absence of a waiver. We find no reason to disturb the district court's threshold determination that an enforceable arbitration clause was in effect. While we hold the federal claims here are not within the scope of the arbitration clause, we also hold that the court correctly compelled arbitration of the state law claims for fraud and breach of fiduciary duties.

7. Of course, if appellants, upon remand of this case to the district court, should withdraw their pendent state law claims, that would

Appendix E

V.

To summarize:

We hold that the district court erred in departing from this Circuit's precedents in granting Shearson's motion to compel arbitration of the claims alleging a violation of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. The district court properly denied the motion to compel arbitration of the RICO claim because of the inherent public interest underlying that cause of action and the need for examining and resolving such disputes in the federal courts. The district court properly compelled arbitration of the pendent state law claims.[8]

Affirmed in part; reversed and remanded in part.

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result in no claims left to be arbitrated. All remaining claims would be litigated in the federal court. And bifurcated proceedings would be avoided. *See AFP Imaging Corp.* v. *Ross, supra*, 780 F.2d at 205.

8. Though the applicability of *Wilko* v. *Swan, supra*, to issues arising under § 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 is settled in this Circuit, it would nonetheless have been helpful if the Securities and Exchange Commission had volunteered an amicus brief to inform us of its views. Without any request, the Commission rendered substantial help with respect to corresponding questions under the Securities Act of 1933 in *Wilko* v. *Swan, supra*—both in this Court, 201 F.2d at 440, 441-42, 445, and in the Supreme Court, 346 U.S. at 427, 428, 440.

APPENDIX F—PERTINENT PROVISIONS OF THE UNITED STATES ARBITRATION ACT

UNITED STATES ARBITRATION ACT
9 U.S.C. § 1 *et seq.*

§ 2. Validity, irrevocability, and enforcement of agreements to arbitrate

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

§ 3. Stay of proceedings where issue therein referable to arbitration

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Appendix F

§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue.

Appendix F

Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

July 30, 1947, c. 392, 61 Stat. 671; Sept. 3, 1954, c. 1263, § 19, 68 Stat. 1233.

APPENDIX G—PERTINENT PROVISIONS OF THE SECURITIES EXCHANGE ACT OF 1934

SECURITIES & EXCHANGE ACT OF 1934
15 U.S.C. § 78

§ 78j. Manipulative and deceptive devices

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> (b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

§ 78o Use of manipulative or deceptive devices; contravention of rules and regulations

> (c)(1) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than commercial paper,

bankers' acceptances, or commercial bills) otherwise than on a national securities exchange of which it is a member by means of any manipulative, deceptive, or other fraudulent device or contrivance, and no municipal securities dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this paragraph, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

(2) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commerical bills) otherwise than on a national securities exchange of which it is a member, in connection with which such broker or dealer engages in any fraudulent, deceptive, or manipulative act or practice, or makes any fictitious quotation, and no municipal securities dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security in connection with which such municipal

securities dealer engages in any fraudulent, deceptive, or manipulative act or practice, or makes any fictitious quotation. The Commission shall for the purposes of this paragraph, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative and such quotations as are fictitious.

(3) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) in contravention of such rules and regulations as the Commission shall prescribe as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility and related practices of brokers and dealers including, but not limited to, the acceptance of custody and use of customers' securities and the carrying and use of customers' deposits or credit balances. Such rules and regulations shall (A) require the maintenance of reserves with respect to customers' deposits or credit balances, and (B) no later than September 1, 1975, establish minimum financial responsibility requirements for all brokers and dealers.

(4) If the Commission finds, after notice and opportunity for hearing, that any person subject

to the provisions of section 781 or 78m of this title or subsection (d) of this section or any rule or regulation thereunder has failed to comply with any such provision, rule, or regulation, in any material respect, the Commission may publish its findings and issue an order requiring such person to comply with such provision or such rule or regulation thereunder upon such terms and conditions and within such time as the Commission may specify in such order.

(5) No dealer (other than a specialist registered on a national securities exchange) acting in the capacity of market maker or otherwise shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or a municipal security) in contravention of such specified and appropriate standards with respect to dealing as the Commission, by rule, shall prescribe as necessary or appropriate in the public interest and for the protection of investors, to maintain fair and orderly markets, or to remove impediments to and perfect the mechanism of a national market system. Under the rules of the Commission a dealer in a security may be prohibited from acting as a broker in that security.

(6) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any

security (other than an exempted security, municipal security, commercial paper, bankers' acceptances, or commercial bills) in contravention of such rules and regulations as the Commission shall prescribe as necessary or appropriate in the public interest and for the protection of investors or to perfect or remove impediments to a national system for the prompt and accurate clearance and settlement of securities transactions, with respect to the time and method of, and the form and format of documents used in connection with, making settlements of and payments for transactions in securities, making transfers and deliveries of securities, and closing accounts. Nothing in this paragraph shall be construed (A) to affect the authority of the Board of Governors of the Federal Reserve System, pursuant to section 78g of this title, to prescribe rules and regulations for the purpose of preventing the excessive use of credit for the purchase or carrying of securities, or (B) to authorize the Commission to prescribe rules or regulations for such purpose.

§ 78aa. Jurisdiction of offenses and suits

The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdictions of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.

Appendix G

Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant of wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, and 1292 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts.

§ 78cc. Validity of contracts

(a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.